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Statement
of

Carolyn Buck, Chief Counsel
Office of Thrift Supervision

concerning

Reducing Regulatory Burden

before the

Subcommittee on Financial Institutions and Consumer Credit
U. S. House of Representatives

March 14, 2002

Office of Thrift Supervision
Department of the Treasury

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I. Introduction

Mr. Chairman, Ranking Member Waters, and members of the Subcommittee, good morning and thank you for the opportunity to discuss the regulatory burden reduction initiatives currently being considered by the Subcommittee. We support this effort. During periods of economic challenge, it is particularly important that we make every effort to remove unnecessary regulatory obstacles that hinder profitability, innovation, and competition in our financial services industry.

Relieving institutions from these burdens meshes well with three responsibilities that our new Director, James E. Gilleran, has stressed with OTS staff:

- Protecting taxpayers by minimizing risks to the insurance fund. Any relief from regulatory burden enhances the safety and soundness of institutions by relieving them from the distraction of complying with unnecessary red tape.

- Keeping the financial institution system healthy. Reducing regulatory burden and enhancing supervision both play an important role in support of our shared goal of assuring the continued health of the financial services system.

- Protecting consumers by fully utilizing the consumer laws we have jurisdiction to enforce.

Support for Other Pending Congressional Initiatives

During the past year, the House has been hard at work to provide regulatory relief in several pieces of pending legislation. The passage of H.R. 974, the "Small Business Interest Checking Act of 2001," by the House on April 3, 2001, is an important step in permitting depository institutions to pay interest on business transaction accounts. As you know, the current limitations are obsolete and are routinely circumvented by sweep accounts and similar vehicles. It is time to modernize this provision.

Another critical relief proposal under consideration is deposit insurance reform. It is long past time to merge the Bank Insurance Fund and the Savings Association Insurance Fund; virtually everyone agrees on this. We strongly support merger because it will promote efficiency in administering the funds and, more importantly, result in a more stable insurance system. We also believe the "free rider" problem should be addressed in the interest of fairness to those who have paid into the funds over many years. The Federal Deposit Insurance Corporation Board should also have sufficient flexibility in setting the designated reserve ratio and deciding when to increase the rate of assessments to assure the continued stability of the insurance fund. Providing certainty about the process for determining the amount of deposit insurance assessments is a very important regulatory burden reduction initiative.

Simplifying the Mortgage Process

Another area woefully in need of reform is the mortgage process. OTS applauds HUD Secretary Mel Martinez's initiatives in this area. Last fall Secretary Martinez spoke to the Mortgage Bankers Association of America about his goal of making "the homebuying experience less complicated, the paperwork requirements less demanding, and the mortgage process itself less expensive." This is no simple task, but everyone involved in making the American dream of homeownership a reality shares his goals, and we pledge to do our part to help achieve this objective. Clearly, simplifying the mortgage process will reduce regulatory burden on thrifts and all housing lenders. The importance of this cannot be overstated.

Today, I will discuss the features of the proposed legislation, the "Financial Services Regulatory Relief Act of 2002,"[1] that are of greatest importance to thrifts and the communities they serve. The most notable of these provisions concerns parity for thrifts with banks under the securities laws. I will also address a number of other provisions in the proposed legislation and suggest a few additions.

II. Streamlining for Thrift Institutions

A. Parity for Thrifts under the Investment Advisers Act of 1940 and the Securities Exchange Act of 1934 (§ 201)

OTS strongly supports the amendments in the proposed legislation that provide parity between thrifts and banks under the federal securities laws. These

[1] Discussion Draft dated March 5, 2002.

provisions primarily involve the investment adviser and broker-dealer registration requirements. Thrifts fill an important niche in the financial services arena by focusing their activities primarily on residential, community, small business, and consumer lending under the Home Owners' Loan Act (HOLA). Some thrifts also make securities services available to their customers through affiliates and contractors that are registered investment advisers or broker-dealers. In addition, thrifts provide investment advisory services as SEC-registered advisers. However thrifts may choose to provide securities services, there is no longer any logical basis to structure the regulatory oversight of thrifts and banks differently. Removing the disparity will reduce regulatory burden by providing cost savings to affected thrift institutions.

As a matter of principle, OTS believes that different purposes of the various charters make our financial services industry the most flexible and successful in the world, but obsolete disparities unrelated to those different purposes only raise costs for institutions and consumers. While OTS strongly supports giving each institution the option to pick the most appropriate charter, that decision should be based on which charter is the best fit for its business. These parity amendments to the securities laws remove distinctions that have caused some thrifts to engage in regulatory arbitrage by changing charters to avoid SEC regulation and reduce costs even though the thrift charter is the best fit for their businesses.

The details of the current situation are complex, and I refer you to the detailed explanation of the OTS proposal on this subject for a description of each problem we have identified to date under current law. The key points, however, may be summarized in a few sentences.

Banks—but not thrifts—are exempt from investment adviser registration requirements under the Investment Advisers Act of 1940. In 1999, the Gramm-

Leach-Bliley (GLB) Act narrowed the bank exemption and now requires a bank to register when it advises a registered investment company, such as a mutual fund.

Banks—but not thrifts—enjoyed a blanket exemption from broker-dealer registration requirements under the 1934 Act before changes made by the GLB Act. That Act removed the blanket exemption and permitted banks to engage only in specified activities without having to register as a broker-dealer. Other activities must be "pushed out" to a registered broker-dealer. The SEC issued interim final rules on May 11, 2001, to implement the new "push-out" requirements.

As part of the broker-dealer "push out" rule, the SEC exercised its exemptive authority to treat thrifts the same as banks. This gave thrifts parity with banks for the first time for purposes of broker-dealer registration, but did not address other problems under the 1934 Act. In the broker-dealer changes, the SEC recognized it would be wrong to continue disparate, anomalous treatment. The May 2001 rule generally gave banks and thrifts until October 1, 2001, to comply, but in response to extensive concerns raised about the rule, the SEC delayed the effective date of the rule until May 12, 2002. At the same time it gave both banks and thrifts the blanket exemption until May 2002. The SEC is now considering comments it received on the rule and will be revising and republishing the rule. It has announced its intent to further extend the effective date of the new requirements.

Treating thrifts and banks the same under the securities laws makes sense for the following reasons:

- The statutory authorities for thrifts and banks to engage in trust services are essentially the same. In 1980, Congress gave thrifts the authority to offer trust services closely based on parallel national bank authority. The Senate report for the Depository Institutions Deregulation and Monetary Control Act of 1980 explained that the HOLA amendment gives thrifts "the ability to offer trust services on the same basis as national banks."[2] Consistent with this legislative history, these amendments further promote uniformity in the way thrifts and banks provide trust services.

- Thrifts and banks provide investment adviser, trust and custody, third party brokerage, and other related services in the same manner, but have been subject to different requirements under the SEC's interpretation of the securities laws.

  - To the extent thrifts are subject to different rules and must register with the SEC, they are placed at a competitive disadvantage to banks due to the additional costs. For this reason, some thrifts have recently converted to a bank or state trust company charter to obtain the benefit of the registration exemption under the Investment Advisers Act. This allows them to side step SEC regulation with a one-time conversion cost. It is sound public policy to treat the bank and thrift charters the same where similarly situated. This approach promotes a level playing field among depository institutions in the marketplace.

  - Some have objected to this change based on concerns that it would give thrifts a competitive advantage over registered investment

[2] S. Rep. No. 96-368, at 13 (1979), reprinted in 1980 U.S.C.C.A.N. 236, 248.

advisers. OTS believes the stronger argument supports comparable regulatory treatment of depository institutions that already have essentially the same powers and that are subject to equivalent, frequent oversight by the appropriate federal banking agency. These amendments will have a relatively minor impact on the investment adviser industry because banks are already exempt.

- OTS agrees with the SEC analysis set forth in its preamble to the May 2001 interim final "push-out" rule. The logic of the SEC argument in the context of the broker-dealer rule applies equally for purposes of extending to thrifts the same investment adviser registration exemption to that applies to banks. The SEC explained the basis for its decision to exempt thrifts from broker-dealer registration to the same extent as banks, as follows:

> "Now that the general exception for banks has been replaced, and the differences between banks and savings associations have narrowed; it seems reasonable to afford savings associations and savings banks the same type of exemptions. Moreover, insured savings associations are subject to a similar regulatory structure and examination standards as banks. We find that extending the exemption for banks to savings associations and savings banks is necessary or appropriate in the public interest and is consistent with the protection of investors." 66 Fed. Reg. 27788 (May 18, 2001).

- The SEC preamble goes on to note that some of the bank registration exemptions, such as those for trust and fiduciary activities, safekeeping and custody, and sweep accounts, could imply that thrifts that have routinely engaged in such activities as part of their HOLA-authorized activities without having to register as a broker-dealer must now register to continue to engage in such activities. The SEC approach and the proposed legislation remove the possibility of this wholly unintended consequence.

- OTS examinations of these activities are already conducted in the same manner as those of the other banking agencies. OTS is formalizing these policies with new regulations and guidance. For example, in August 2001 OTS issued an entirely revised trust and asset management handbook. Under OTS's regulations and examinations, thrift customers have protections equivalent to those the other banking agencies provide for bank customers.

- Securities firms that provide investment adviser or broker-dealer services by contract with thrifts and banks will not have the regulatory burden of having to follow different rules, depending on whether a thrift or a bank is involved. Where different rules apply, additional compliance costs are borne by thrifts as well as banks, by securities firms that provide services for them under contract, and, ultimately, by all of their customers.

- Wherever possible, the banking agencies establish uniform standards to protect consumers when their regulated financial institutions are engaged in exactly the same activities, in the same manner. If thrifts and banks are subject to different rules under the securities laws, the banking agencies are not able to establish a uniform regulatory scheme and a level playing field.

The SEC is currently considering giving thrifts the same exemption banks have from investment adviser registration requirements; however, it is not yet clear whether this will occur. We have been actively engaged in recent months in encouraging the SEC to grant an exemption providing full bank-thrift parity, along the lines of the broker-dealer exemption the SEC extended to thrifts last year. While the SEC is moving towards parity for thrifts and banks, we urge Congress to affirm SEC action quickly in these areas and to make the changes necessary to eliminate the numerous incidental differences that remain. This would have the beneficial effect of avoiding the need for a series of SEC administrative exemptions—another potential regulatory burden—if additional differences come to light.

B. Public Welfare Investments (§ 202)

The proposed legislation updates HOLA to give thrifts the same authority national banks and state member banks have to make investments to promote the public welfare. This amendment enhances the ability of thrifts to contribute to the growth and stability of their local communities. It replaces an outdated statutory reference to HUD's Community Development Block Grant (CDBG) program under Title I of the Housing and Community Development Act of 1974. This change will eliminate confusion that can arise when thrifts seek to invest in community development projects and companies.

Under current law, a savings association may invest up to 5 percent of its assets in real estate and in mortgage loans on property located in areas receiving concentrated development assistance by a local government under HUD's CDBG program. Of this total, no more than 2 percent of assets may be invested directly in real estate. As a result of changes to the CDBG program that occurred in

1981—more than 20 years ago—thrift investment opportunities that meet the technical requirements of the statute are rare; and OTS has found it cumbersome to promote the spirit and intent of Congress's determination to allow thrifts to make such community development investments.

Currently, using its administrative authority, OTS will issue a "no action" letter where a thrift seeks to make a community development investment that satisfies the intent of the existing provision, but does not clearly fall within the wording of the statute or the "safe harbor" criteria issued by OTS for such an investment.

To eliminate confusion and avoid the delays inherent in issuing "no action" letters, the proposed legislation would give thrifts community development investment authority comparable to the authority of national banks and state member banks to make investments "for the primary purpose of promoting the public welfare." Under the proposal, thrifts may make investments primarily designed to promote the public welfare, directly or indirectly by investing in an entity primarily engaged in making public welfare investments. As with bank authority, the proposal has an aggregate limit on investments of 5 percent of a thrift's capital and surplus, or up to 10 percent on an exception basis.

Under the amendment, thrifts may use the new investment authority without regard to the general prohibition against thrifts acquiring or retaining corporate debt that is not of investment grade.[3] No similar limitation applies to banks. A nonprofit organization engaged in community development activities may finance its activities by issuing debt securities that are not rated and, therefore, are not of investment grade. This change enhances the ability of thrifts

[3] See section 28(d) of the FDIA (12 U.S.C. 1831e(d)).

to invest in such nonprofit organizations by acquiring or retaining this category of securities.

C. Removal of Obsolete Geographic Limitation on Thrift Investments in Service Companies (§ 503)

OTS strongly supports the provision authorizing federal thrifts to invest in service companies without regard to geographic restrictions. Under current law, a federal thrift may only invest in a service company that is chartered in the savings association's home state. HOLA imposed this geographic restriction before interstate branching and before technological advances such as Internet and telephone banking, and it no longer serves a useful purpose. This requirement has complicated the ability of thrifts, which often operate in more than one state, to join together to obtain services at lower costs due to economies of scale. By removing the geographic limitations on thrift service company investments, this provision enhances a thrift's ability to invest in service companies wherever its business is located without regard to the location of the home offices of other thrifts.

Today, a thrift seeking to make investments through service companies must create an additional corporate layer—known as second-tier service companies—to invest in enterprises located outside the thrift's home state. Requiring the formation of second-tier service companies serves no rational business purpose and results in unnecessary expense and burden on federal thrifts. The effect is to discourage otherwise worthwhile investments.

D. Authority for Federal Thrifts to Merge and Consolidate with Their Nonthrift Affiliates (§ 203)

OTS favors giving federal thrifts the authority to merge with one or more of their nonthrift affiliates, equivalent to recently-enacted authority for national banks.[4] The new authority neither affects the requirement to comply with the Bank Merger Act, nor gives thrifts the power to engage in new activities.

Under current law, a federal thrift may merge only with another depository institution. This proposal reduces regulatory burden on thrifts by permitting certain mergers, where appropriate for sound business reasons and if otherwise permitted by law. Today, if a thrift wants to acquire the business of a non-depository institution affiliate, it must engage in a series of transactions, such as merging the affiliate into a subsidiary and liquidating the subsidiary into the thrift. Structuring a transaction in this way can be costly. Under this amendment, thrifts may merge with affiliates and continue to have the authority to merge with other depository institutions, but may not merge with other kinds of entities.

E. Streamlining Agency Action under the Bank Merger Act (§ 609 and § 607)

OTS supports the amendment in section 609 to streamline Bank Merger Act application requirements by eliminating the requirement that each federal banking agency request a competitive factors report from the other three banking agencies and the Attorney General. This means five agencies must consider the competitive effects of every proposed bank or thrift merger. The vast majority of proposed mergers do not raise anti-competitive issues, and these multiple reports, even for those few that do raise issues, are not necessary. Decreasing the number to two—coupled with

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[4] See section 6 of the National Bank Consolidation and Merger Act (12 U.S.C. 215a-3), which was added by section 1206 of the Financial Regulatory Relief and Economic Efficiency Act of 2000 (Pub. L. No. 106-569, 114 Stat. 2944, 3034 (2000)).

notice to the Federal Deposit Insurance Corporation, as the insurer—streamlines the review of merger applications.

OTS also supports section 607, which amends the Bank Merger Act to shorten the post-approval waiting period before a transaction subject to the Act may be consummated. After approval, except in the case of emergencies, mergers are subject to a 30-day waiting period to give the Attorney General time to initiate legal action where the Attorney General determines the merger would have a significantly adverse effect on competition. The agencies may agree, with concurrence of the Attorney General, to shorten the waiting period to 15 days. Section 607 removes the 15-day statutory minimum. Permitting a merger to go forward sooner will reduce burden on the affected depository institutions.

F. Repeal of Statutory Dividend Notice Requirement for Thrifts in Savings and Loan Holding Companies (§ 204)

The proposed legislation repeals the requirement that any thrift owned by a savings and loan holding company must notify OTS 30 days before paying a dividend. Instead, the Director has the discretion to require prior notice and may establish reasonable conditions on the payment of dividends.

The current section 10(f) dividend notice requirement does not depend on a thrift's capital condition or relative risk to the insurance fund. No similar limitation based on the ownership of a depository institution, rather than its condition, applies to thrifts controlled by individuals, thrifts controlled by bank holding companies, or banks. There is no basis for disparate treatment based on the form of ownership of thrifts.

Federal statutes and regulations assure that thrifts held by holding companies may not pay dividends in inappropriate circumstances, and this amendment confirms this authority. All thrifts are subject to the prompt corrective action—PCA—provisions that generally prohibit an insured depository institution from paying a dividend if doing so would make it undercapitalized. In addition, based on OTS's general regulatory authority, OTS has a capital distributions regulation[5] governing when a thrift must file an application or give notice if it decides to pay a dividend. The rule conforms our dividend requirement more closely to those of the other federal banking agencies. In 1999, as part of OTS's ongoing regulatory burden reduction effort, OTS amended its regulations to exempt adequately capitalized, highly rated savings associations from providing advance notice of dividends under certain circumstances. This proposal will permit OTS to extend the same regulatory relief to thrifts that happen to be owned by holding companies if it determines such relief is appropriate.

III. Safety and Soundness Proposals

A. Examination Flexibility (§ 601)

OTS strongly supports the additional flexibility in the proposed legislation to adjust the examination cycle for depository institutions. The Federal Deposit Insurance Act (FDIA) currently requires annual examinations for all but the smallest institutions. Small institutions that have assets less than $250 million and are well-capitalized and well-managed may be examined every 18 months. A large majority of savings associations are well-run institutions that do not require full-fledged annual examinations to assure their safety and soundness. This is also true for the majority of banks. This amendment will reduce risk to the insurance

[5] 12 CFR part 563, subpart E

fund by permitting the banking agencies to focus supervisory attention on the institutions that are, or are at the greatest risk of becoming, troubled.

B. Enhanced Authority to Enforce Agreements (§ 406)

OTS welcomes inclusion of the amendments made by section 406 to enhance the safety and soundness of insured depository institutions and protect the insurance fund from unnecessary losses. The amendment clarifies that sections 8(b)(6)(A)(i) and (ii) and section 38(e)(2)(E) of the FDIA do not apply when a federal banking agency seeks to enforce certain conditions imposed on, and agreements with, institution-affiliated parties (IAPs). Some courts have interpreted these provisions to limit the ability of banking agencies to require an IAP to transfer capital to an institution under such conditions and agreements.

Neither of these two sections should apply when a banking agency seeks to require an IAP to meet its prior obligations. Agencies must be able to count on financial commitments an IAP makes to support a depository institution in connection with its application for a charter or in any other agreement. It is illogical to reduce or eliminate an IAP's commitment at the very time the institution most needs it. The sections in question make sense only in the context of an agency seeking to impose additional requirements to resolve problems at a troubled depository institution.

Section 406 also amends section 18(u)(1) of the FDIA, which prohibits a receiver for an IAP in bankruptcy from seeking the return of amounts the IAP has transferred to a depository institution if at the time of the transfer the institution is then undercapitalized, and two other conditions are met. It should not matter whether the institution is undercapitalized at the time of the transfer. The effect of this provision could be to delay a capital infusion designed to save the institution until it is too late, or at least until the institution is in even greater trouble (i.e., until it becomes undercapitalized). This amendment removes this risky unintended consequence.

IV. Other Initiatives Not in the Proposed Bill

I would like briefly to discuss two other initiatives that OTS believes would be improvements to the legislation and urge the Subcommittee to include them in the bill.

A. Creation of Statutory OTS Deputy Directors

OTS seeks an amendment to HOLA to give the Treasury Secretary statutory authority to appoint up to four Deputy Directors for OTS. The new authority would be based closely on long-standing authority[6] for appointing Deputy Comptrollers in the Office of the Comptroller of the Currency (OCC). Consistent with the existing OCC legislation, the HOLA amendment would require the Treasury Secretary to make the OTS appointments so each Deputy Director would qualify as an "inferior officer" under the Appointments Clause of the Constitution.

The safety and soundness of the banking system depend on regular, uninterrupted oversight by the federal banking agencies. This amendment would remove any question about a Deputy Director's authority to perform the functions of the Director during a vacancy in the office of the Director or during the absence or disability of the Director. The reality of the appointments process is that there can be a delay of many months before a sub-cabinet level position is filled, and

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[6] 12 U.S.C. 4

these delays have grown significantly over the last 20 years. In light of these growing delays, it is especially important to establish a chain of command within OTS that will avoid the possibility of gaps in authority to regulate and supervise savings associations, eliminate uncertainty for the thrifts OTS regulates, and avoid future litigation over whether the acts of OTS staff are valid.

OTS is the only financial services sector regulator that could be readily exposed to this vacancy problem. During a vacancy, OTS succession now occurs through the process of the Vacancies Act, which does not ensure an immediate succession when the OTS Director departs and limits the period an acting Director may serve. The organic statutes of the other financial regulators minimize or avoid vacancy problems by providing for automatic and immediate succession or by vesting authority in the remaining members of a board or commission.

B. Streamlining Thrift Multistate Multiple Savings and Loan Holding Company Acquisitions

OTS recommends replacing the current restriction in section 10(e)(3) of HOLA on multiple savings and loan holding companies (SLHCs) acquiring and holding thrifts in different states with the authority to approve such transactions subject to the requirements of the Savings and Loan Holding Company Act (section 10 of HOLA). There is no basis for retaining the existing restriction on branching, especially in light of the amendments in the proposed legislation permitting national banks to branch through the acquisition of out-of-state de novo institutions and permitting banks and bank holding companies to acquire an out-of-state bank even if it has not been in existence for a certain period of time set by a state.

A SLHC may now avoid the existing limitation by purchasing a thrift in another state and merging it with its federal thrift subsidiary. The amendment would eliminate this regulatory burden by giving SLHCs the choice of whether to merge the thrifts, subject to OTS approval in accordance with generally applicable rules governing holding company acquisitions. The current law results in two anomalies. First, it limits authority of thrift holding companies to acquire out-of-state thrifts and hold them as separate subsidiaries, but permits thrifts to branch on a nationwide basis. Second, it limits the authority of a thrift holding company to acquire an out-of-state thrift and hold it as a separate subsidiary, but permits a bank holding company to do so.

V. Conclusion

OTS is committed to reducing burden wherever it has the ability to do so consistent with safety and soundness and compliance with law. The proposed legislation advances this objective, and we appreciate that many of the reforms we have long desired are included in the proposed legislation. I especially thank you, Mr. Chairman, and the others who have shown leadership on this issue, and look forward to working with the Subcommittee to shape the best possible regulatory burden reduction legislation.